

In Re: 6161 Shelby Oaks LLC)
 Personal Property Account No. P-017441) Shelby County
 Tax year 2005)

Statement of the Case

APPRAISAL	ASSESSMENT
\$417,500	\$125.250

The undersigned administrative judge conducted a hearing of this matter on October 19, 2006 in Memphis.² The appellant, 6161 Shelby Oaks Drive, LLC, was represented by Jerry H. Schwartz, Esq. (Memphis). Assistant County Attorney Thomas Williams appeared on behalf of the Shelby County Assessor of Property ("Assessor").

The subject property is used (or held for use) in the operation of a health club at Shelby Oaks Corporate Park. The appellant, a Tennessee limited liability company whose sole member is Frank Frisch, acquired the approximately 7.5 acres of land, improvements, machinery, equipment, and pro shop inventory associated with this enterprise from Belz-Wilson Properties ("Belz-Wilson") on December 31, 2004 for \$2,250,000.³ Since September 1 of that year, another entity controlled by Mr. Frisch (Health & Fitness Management, LLC) had been

Although this appeal to the State Board was prematurely filed, the taxpayer did ultimately exhaust its administrative remedies before the local board of equalization. In light of that fact, the administrative judge deems the appeal to be properly before the State Board both as to both the original and back assessment/reassessment of the subject property.

³The purchaser agreed to pay \$300,000 in cash, and the balance in the form of a promissory note.

operating the business as successor to a lessee which had defaulted on a \$2 million promissory note to Belz-Wilson.⁴ The purchase price included the outstanding note; executory customer service contracts; and other intangibles.

On its tangible personal property schedule for tax year 2005 (Exhibit 5), the appellant reported a value of \$47,229 – the amount which had been allocated to furniture, fixtures & equipment in the Asset Purchase Agreement (Exhibit 6). The remainder of that allocation was as follows:

<u>Real Property (land and improvements)</u>	\$1,900,000
<u>Promissory Note (discounted)</u>	\$ 200,000
<u>Inventory</u>	\$ 91,671 ⁵
<u>Executory Health Club Agreements</u>	\$ 10,000
<u>Accounts Receivable</u>	\$ 1,000
<u>Intangible Property (including goodwill)</u>	\$ 100

In the 2005 county-wide reappraisal, the Assessor valued the real property which the appellant had bought from Belz-Wilson at the \$1.9 million amount shown above and on the face of the warranty deed (Exhibit 4).⁶ But the Assessor did not accept the purported value of the personal property. Instead, she assessed the Group 1, 2, and 8 items purchased by the appellant on the basis of their *historical* cost on file, and valued the personal property leased by the appellant according to the information entered on Part III of the schedule. In the ensuing audit, the Assessor concluded that the leased personal property had been undervalued by \$73,609. Exhibit 8.

Characterizing its acquisition of these health club assets as an arm's-length transaction, the appellant contended that the subject property should be valued as in the negotiated purchase price allocation. Health club machinery and equipment, Mr. Frisch testified, tends to depreciate very rapidly because of technological obsolescence as well as constant wear and tear.

Counsel for the Assessor maintained that "the purchasers had a prior security and use interest in the subject assets, and the sale should not be considered an arm's-length transaction." Post-Hearing Brief, p. 6.

⁴Mr. Frisch was part of an investment group which had loaned money to the former tenant in connection with its purchase of the business.

⁵As explained by Mr. Frisch, this amount represented 50% of the total "adjusted" (depreciated) cost for the items inventoried by the previous owner of the business as of August 31, 2002. Exhibit 3.

⁶The Assessor's land/building breakdown differed considerably from that specified in the purchase price allocation.

Under Tenn. Code Ann. section 67-5-601(a), “[t]he value of all property shall be ascertained from the evidence of its sound, intrinsic and immediate value, for purposes of sale between a willing seller and a willing buyer without consideration of speculative values....” Pursuant to Tenn. Code Ann. sections 67-5-901 et seq., the State Board has adopted a schedule for the reporting of tangible personal property. The schedule incorporates the statutory rates of allowable depreciation for the various categories of property listed in Tenn. Code Ann. section 67-5-903(f). State Board Rule 0600-5-.06 establishes a presumption that the fair market value of commercial and industrial tangible personal property other than raw materials, supplies, and scrap is “the original cost **to the taxpayer** less straight line depreciation, or the residual value, whichever is greater.” [Emphasis added.] This presumption is rebuttable (by either the taxpayer or the assessor) upon the presentation of sufficient evidence to support a “non-standard” valuation. State Board Rule 0600-5-.07.

In this state, except as otherwise provided in Tenn. Code Ann. section 67-5-502(c), leased personal property which is used for business purposes is assessed to the **lessee**.

As the party seeking to change the present valuation of the subject property, the appellant has the burden of proof in this administrative proceeding. State Board Rule 0600-1-.11(1).

Although the terms *historical cost* and *original cost* are sometimes used interchangeably, there is an important distinction between them in the realm of personal property assessments. As explained in an authoritative textbook:

Historical cost is the actual or first cost of a property at the time it was originally constructed and placed in service. It should not be confused with *original cost*, the latter term more properly being used to designate the **actual cost to the present owner**, who may have purchased the property at a price more or less than the historical or first cost. [Emphasis added.]

American Society of Appraisers, *Appraising Machinery and Equipment* (1989), p. 60.

Consistent with the cited rules of the State Board, the instructions for completion of the Assessor’s Tangible Personal Property Schedule (2005) advised the taxpayer to “[l]ist the total cost **to you** for each group below by year acquired.” [Emphasis added.]

Unfortunately, however, the appellant did not buy the personal property in question separately. So the question arises: How should the cost to a taxpayer be determined in this kind of situation?⁷

⁷On January 23, 2006, the State Board held a hearing on proposed amendments to its rules governing the assessment of tangible personal property. Those amendments, *inter alia*, would have clarified the definition of the “original cost” in Rule 0600-5-.01 and required a buyer of used personal property to “provide proof that the price or allocated price claimed as the current owner’s cost reasonably approximates the current value” of such property. To date, the State Board has taken no action on the proposed rulemaking.

In PCS Nitrogen Fertilizer LP (Shelby County, Tax Year 1999, Order on Review of Preliminary Legal Issues, August 10, 2006), the taxpayer (PCS) had acquired a manufacturing plant through the purchase of all the outstanding shares of stock in the former owner (Arcadian). As recited in the State Board's interlocutory order:

The (tangible personal) property was reported for tax year 1999 using Arcadian's historical cost rather than the original cost as allocated by PCS. The assessor discovered PCS' allocated cost was much higher when she audited the account in 2000, and she reassessed the property at a value of over \$66 million versus the approximately \$26 million originally reported.

Id. at p. 1.

By contrast, in the instant case, it is the Assessor who would resort to the historical cost of the assets newly acquired by the taxpayer.

To be sure, the purchase price allocation set forth in Section 3.3 of the Asset Purchase Agreement was not backed by an independent appraisal. And there was no firsthand testimony by a representative of Belz-Wilson or other knowledgeable source regarding the level of exposure of the subject property in the open market. But Mr. Williams' assertion that "the purchase price is not indicative of fair market value" (Post-Hearing Brief, p. 6) is undermined by the Assessor's own appraisal of the real property transferred. Further, there is no indication that the seller was under any financial or other duress.

Generally, "a bona fide sale of the subject property is considered the best evidence of market value." International Association of Assessing Officers, *Property Appraisal and Assessment Administration* (1990), p. 153. In the opinion of the administrative judge, the evidence of record at least establishes a *prima facie* case that Belz-Wilson's sale to the appellant was an arm's-length transaction. Having been instructed to report *its* cost for the personal property in question, the new owner justifiably entered the value assigned in the purchase price allocation in the "revised cost" column.

While a purchase price allocation may not afford adequate basis for a claim of *non-standard value*⁸, the taxpayer has not propounded such a value here. Rather, albeit in the form of an adjusted assessment of the subject property, the Assessor has posited a value other than the actual depreciated cost to the present owner. Respectfully, the administrative judge does not regard "cost on file" figures alone to be "sufficient evidence" within the meaning of State Board Rule 0600-5-.07 for adoption of what practically amounts to a non-standard value in this case.

The Asset Purchase Agreement, of course, did not transfer ownership of the tangible personal property on the premises leased from other parties. The Assessor's post-audit valuation of those assets (\$161,715) was not persuasively rebutted. Addition of that value to

⁸See American Water Heater Company (Washington County, Tax Year 2003, Final Decision and Order, September 28, 2004).

the allocated price for the furniture, fixtures & equipment sold (\$47,229) results in a total value of \$208,900, after rounding.

Order

It is, therefore, ORDERED that the following values be adopted for tax year 2005:

APPRAISAL	ASSESSMENT
\$208,900	\$62,670

Pursuant to the Uniform Administrative Procedures Act, Tenn. Code Ann. §§ 4-5-301—325, Tenn. Code Ann. § 67-5-1501, and the Rules of Contested Case Procedure of the State Board of Equalization, the parties are advised of the following remedies:

1. A party may appeal this decision and order to the Assessment Appeals Commission pursuant to Tenn. Code Ann. § 67-5-1501 and Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization. Tennessee Code Annotated § 67-5-1501(c) provides that an appeal **“must be filed within thirty (30) days from the date the initial decision is sent.”** Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization provides that the appeal be filed with the Executive Secretary of the State Board and that the appeal **“identify the allegedly erroneous finding(s) of fact and/or conclusion(s) of law in the initial order”**; or
2. A party may petition for reconsideration of this decision and order pursuant to Tenn. Code Ann. § 4-5-317 within fifteen (15) days of the entry of the order. The petition for reconsideration must state the specific grounds upon which relief is requested. The filing of a petition for reconsideration is not a prerequisite for seeking administrative or judicial review.

This order does not become final until an official certificate is issued by the Assessment Appeals Commission. Official certificates are normally issued seventy-five (75) days after the entry of the initial decision and order if no party has appealed.

ENTERED this 2nd day of February, 2007.

Pete Loesch

PETE LOESCH
ADMINISTRATIVE JUDGE
TENNESSEE DEPARTMENT OF STATE
ADMINISTRATIVE PROCEDURES DIVISION

cc: Jerry H. Schwartz, Law Offices of Jerry H. Schwartz, PC
Assistant County Attorney Thomas Williams
Tameaka Stanton-Riley, Appeals Manager, Shelby County Assessor's Office

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